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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	Report to Congress

REPLY COMMENTS

BellSouth Corporation, on behalf of itself and its affiliated companies, ("BellSouth") hereby submits its Reply Comments in response to the comments filed regarding the Public Notice in connection with the Report to Congress on Universal Service which the Commission is required to make.[1]

The Common Carrier Bureau solicited comments on the five areas in which the Commission is required to report to Congress regarding its implementation of the universal service provisions of the Communications Act.[2] In these Reply Comments, BellSouth will focus on a single issue: the Commission's conclusion that the federal fund should only provide twenty-five percent of the support determined to be necessary to maintain universal service.

Before addressing this issue, a brief digression is warranted to discuss the Commission's policies regarding which telecommunications providers are exempted from contributing to the fund. As a general matter, the expectation of Congress was that the Commission would have the widest possible group of providers contributing to the upkeep of the physical infrastructure that

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1 Common Carrier Bureau Seeks Comment for Report to Congress on Universal Service Under the Telecommunications Act of 1996, CC Docket No. 96-45 (Report to Congress), Public Notice, released January 5, 1998 (hereinafter "Public Notice").

2 47 U.S.C. § 254.

is necessary to provide universal service.[3] Some commenting parties express dismay at the fact that the Commission has exempted ISP providers *in toto* from contributing to the federal universal service fund.[4] Without question, ISP providers are using the Internet to provide telecommunications services and, at least to that extent, ought to be treated the same as other telecommunications providers and be required to contribute to the support of universal service. Such consistency is the minimum necessary to achieve a competitively neutral, equitable and non-discriminatory contribution mechanism that the Communications Act requires.

Identifying and including all telecommunications providers as contributors to the federal fund is an important corollary to the paramount implementation issue faced by the Commission, the appropriate size of the federal universal service fund. In its Comments, BellSouth advised the Commission that the twenty-five percent factor the Commission plans to use to size the federal universal service fund would substantially under-fund the federal universal service fund.[5] The clear consequence of an under-funded federal universal service fund is to shift the burden and responsibility of universal service to the states. Such a result is neither contemplated nor sanctioned by Section 254 of the Communications Act.

The comments of the state commissions validate BellSouth's admonition. As the Mississippi Public Service Commission observes, the "FCC's current proposal does not meet the requirements of the Telecommunications Act of 1996 and places an unreasonable burden on

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3 *See* Comments of Senator Ted Stevens and Senator Conrad Burns.

4 *See, e.g.*, AirTouch at 27-28 and AT&T at 10-11.

5 BellSouth at 10.

those states with high cost rural areas."[6] The Mississippi Commission's concern is echoed by state commission after state commission.[7]

Many of the state commissions believe that the most straightforward remedy is for the Commission to fund 100 percent of universal service support. For example, the joint comments of 14 state commissions[8] emphasize the fact that universal service support funded through a federal fund will "eliminate or mitigate the need for varying state universal service surcharges and will contribute greatly towards achieving the goals of reasonably comparable and affordable rates."[9] In urging the Commission to increase the amount of universal service support provided through the federal fund, all of the state commissions believe such action is essential to achieving the Communications Act's universal service goal of affordable telephone service for all customers.

In BellSouth's view, the federal fund, at a minimum, must be sufficient to make explicit the subsidies that are implicit in interstate access charges. The Commission also has the authority to assume a greater responsibility as suggested by the state commissions. For example, as an initial matter the Commission could, in addition to removing the subsidies from interstate

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6 Mississippi at 1.

7 *See, e.g.*, Colorado at 3 ("a state like Colorado with its many rural customers will suffer if the Commission's decision to support only 25% remains unchanged"); Wisconsin at 4-6 ("entire states can be considered high cost areas. Requiring such states to pay the majority of their subsidies themselves is self-defeating."); Washington at 2 ("75 percent to the state jurisdiction puts too much upward pressure on rates for basic service in high cost states").

8 The state commissions participating in the joint comments are: Alabama, Alaska, Arkansas, Georgia, Idaho, Kentucky, Maine, Montana, New Hampshire, New Mexico, North Carolina, South Carolina, Vermont and West Virginia. (hereinafter "Alabama *et. al.*").

9 Alabama *et. al.* at 5.

access charges, continue in some form the direct support that the states receive from the existing high cost fund.[10]

While BellSouth concurs with the general view expressed by the state commissions that the federal fund should be increased, the Commission cannot simply take the federal fund and turn the proceeds over to the state commissions.[11] Such an approach simply ignores the statutory mandate that the Commission make explicit existing implicit subsidies. Such implicit subsidies continue to exist in interstate access charges and the only fund that can address such implicit subsidies is the federal universal service fund. Thus, a necessary result of implementing the federal universal service fund is that interstate access charges be reduced to remove the implicit universal service subsidies. While the Commission can expand the federal universal service fund

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[10] The high cost fund permits states with higher than average costs to allocate additional costs to the interstate jurisdiction which are then recovered through an interstate high cost fund. Thus, the high cost fund directly supports lower local rates and the amounts received from the high cost fund, appropriately, are not used to reduce interstate access charges.

[11] Alabama *et. al.* suggest that the Commission follow an alternative approach called the "Ad Hoc Proposal" that is being developed by members of NARUC. The Proposal was provided to the Commission as an *ex parte* presentation on January 16, 1998. This proposal is flawed in a number of respects. BellSouth attaches to these Reply Comments a brief critique of the Ad Hoc Proposal.

to take into account intrastate implicit subsidies, the Commission cannot simply ignore existing interstate implicit subsidies.

Respectfully submitted,

BELLSOUTH CORPORATION

By: ______________________

M. Robert Sutherland
Richard M. Sbaratta
Rebecca M. Lough

Its Attorneys

Suite 1700
1155 Peachtree Street, N. E.
Atlanta, Georgia 30309-3610
(404) 249-3386

Date: February 6, 1998

ATTACHMENT 1

BellSouth Analysis Of

NARUC Ad Hoc Working Group on Funding for High Cost Areas Paper: *High Cost Support: An Alternative Distribution Proposal*

The NARUC Ad Hoc Working Group has prepared a proposal to address universal service concerns which purports to be a compromise between high cost and low cost states that will resolve, on an interim basis, outstanding universal service issues.[1] As discussed below, the Working Group's proposal is flawed in a number of respects. The Working Group's proposal is an act of desperation to avoid the conundrum the Commission's universal service approach causes the individual states, *i.e.*, each state having to fund seventy-five percent of its universal service support needs. Thus, the Working Group's proposal side steps the real issue, the appropriate size of a universal service fund, and is willing to settle for an inadequate fund in exchange for state control of fund disbursements.

The Working Group's proposal will not work. It is contrary to the Communications Act's requirement that the universal service support be sufficient, predictable and explicit. The Working Group incorrectly believes that it is striking a compromise between low cost states and high cost states. To the contrary, high cost states will be forced to shoulder the burden of universal service and internally generate substantial amounts of support for universal service. The ultimate consequence is that consumers in high cost states, such as those served by BellSouth, will bear a disproportionate share of the responsibility for universal service support. This simply is not the intended result of the Communications Act. Indeed, the logic and purpose of a mandated federal universal service fund is to avoid such an outcome.

BellSouth shares the state commissions' concerns with the Commission's current proposal to place seventy-five percent of the responsibility for funding universal service support with the individual states. The remedy, however, remains an adequately sized federal universal service fund that permits implicit universal service subsidies to be removed from all telecommunications service rates.[2]

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[1] Ex Parte filed by Birch Horton Bittner and Cherot, January 16, 1997 [sic], in CC Docket No. 96-45. Attached was a working paper entitled "High Cost Support: An Alternative Distribution Proposal," dated January 15, 1998.

[2] For example, the interim high cost fund permits states with above average costs to assign additional costs to the interstate jurisdiction. These costs are recovered through the interim federal universal service fund. Recovery of such costs from the federal universal service fund does not reduce interstate access charges and hence, the intrastate jurisdiction benefits directly

Below, BellSouth addresses a number of concerns that are associated with the Working Group's proposal below:

1. The Working Group suggests that funds from the federal universal service fund should be used solely to reduce intrastate rates rather than interstate access charges. While a federal fund could also provide the means for removing implicit support found in intrastate rates, the proposal ignores entirely the implicit support that has traditionally been reflected in interstate access charges. Interstate rates currently provide implicit support to universal service and therefore assist in keeping local rates at an affordable level. Other than the support associated with the existing interstate USF, it is simply not appropriate for the interstate fund to be used solely to reduce intrastate rates. The Communications Act requires that implicit subsidies be made explicit and, accordingly, the Commission has the obligation to use the federal universal service fund to remove the implicit subsidies from interstate access charges. The federal fund, of course, could be sized so as to provide also for removing a part of the implicit subsidies contained in intrastate rates. The Commission, however, is simply not free to ignore the interstate implicit subsidies.

Even if the federal fund were sized so as to address intrastate implicit subsidies, such federal funding would not mean that state commissions have unconstrained license to use those funds to reduce local rates, as apparently perceived by the Working Group. For example, the Working Group's proposal would permit states to reduce any rates, including basic local dial tone service. This proposal overlooks the fact that the purpose of the universal service fund is to eliminate implicit support. It would be inconsistent with the Communications Act's requirements regarding universal service to reduce residential basic local exchange service rates, while retaining implicit subsidies in rates traditionally used to keep basic local exchange services affordable. Rather than making implicit support explicit, as required by the Act, such a result would embed implicit subsidies in intrastate service rates.

2. The Working Group's proposal arbitrarily limits the size of the fund. Without trying to develop accurate costs for providing universal service, the plan seeks to provide a "compromise" by sizing the federal universal service fund at a level that is as close to current federal loop and switch support programs as "reasonably practical." While the plan states that it provides federal support for "at least some high cost areas" (p. 7), such result is accidental because the fact of the matter is that the support would be tied to the national average cost of providing the defined services, not to high cost areas. Support would only be

from the cost assignment/ universal service fund recovery mechanism. The permanent federal universal service fund, in addition to removing the implicit subsidies currently present in interstate access charges, could also continue direct intrastate support.

provided to states with average costs higher than the national average. States with costs lower than the national average get no support from the federal fund even though such states have high cost areas. In these instances, the individual states would be responsible for supporting these high cost areas from a state funding mechanism.

It is readily apparent that a funding mechanism based on a national average cost is inappropriate. This can be illustrated using the same example presented in the Working Group's proposal. The Working Group's proposal provides an example of the support which would be provided on a per line basis for Alabama:

Cost/line/month using "blended" Hatfield and BCPM results:	$37.42
National average cost/line/month	28.12
Difference	$ 9.31

Federal support is set equal to 75% of the amount between the state average cost and the national average cost. For Alabama, this would equal $6.89 per line per month which would be sent to the Alabama Public Service Commission for distribution.

A state average cost per line masks the real cost of providing universal service and the need for support. Targeting serving wire centers or smaller areas properly identifies the support requirements in specific geographic locations. It targets support to those areas truly in need of assistance in keeping basic rates affordable. For example, expanding upon the analysis performed by the Working Group for Alabama, results from the BCPM 3.1 serving wire center level calculations show that the cost /month/line to serve Birmingham (BRHMALFS) is $22.03 and to serve Eutaw (EUTWALBO) is $171.98.

The averaged cost approach of the Working Group ignores the fact that competitive local exchange carriers (CLECs) will target low cost - high revenue customers in areas like Birmingham. The availability of $6.89 per line support would be "icing on the cake" for these CLECs. On the other hand, it is unlikely that CLECs would choose to serve Eutaw where costs are significantly higher than the $6.89 per line support they would receive.

To ensure that the forward-looking cost methodology does not result in too large a fund, the proposal also directs the analysis of embedded cost studies for comparison purposes. To reduce the fund size further, the "threshold" figure was increased arbitrarily by five percent. The purpose of using embedded costs is that forward-looking costs could be higher in some circumstances than embedded costs. Selectively choosing factors for the single purpose of reducing universal service support simply will not be able to withstand judicial scrutiny.

3. The Working Group's proposal would create a federal fund which bases contributions on only interstate revenues of interstate carriers. Intrastate revenues would not be used. There appears to be some confusion about the ability of the states to consider inter and intrastate revenues in determining a carrier's contribution to an intrastate fund. It is BellSouth's belief that the revenue base for determining carriers' relative contributions should be as broad as possible. The revenue bases for interstate funding and intrastate funding purposes must be consistent. Therefore, if the federal fund uses both interstate and intrastate revenues of interstate carriers to determine relative contributions to the federal universal service fund, the states should also use intrastate and interstate revenues of intrastate carriers to determine the relative contributions to a state universal service fund.

4. Although the Working Group's proposal purports to be sufficient to keep rural intrastate rates reasonably comparable to urban areas, the proposal does not meet the mandate of the Act that support be made explicit. Implicit support contained in ILEC rates remains and is unavailable to CLECs who might wish to enter a high cost area.

5. Unlike the Commission's plan, the Working Group's proposal does not bifurcate the funding for rural and non-rural carriers. The size of a carrier is not considered in the calculation. This ignores the fact that there may be different cost variables for small rural carriers than for non-rural carriers. The record is not developed enough in this area since the FCC in its cost proxy proceeding has focused on large, price cap company costs.

6. The Working Group's proposal fails to provide any requirements regarding the removal of implicit subsidies. It also provides states with a great deal of discretion in distributing universal service funds. Indeed, there is no requirement that states even address universal service, a particularly troubling aspect of the Working Group's proposal. In addition, the proposal appears to accept the Commission's proposed $31 revenue benchmark for use in determining the size of the fund. It ignores the fact that basic local service rates are significantly below the $31 and utilization of the Commission's benchmark embeds the implicit support contained in services such as switched access, vertical services, and toll services.

Not only does the proposal ignore the need for addressing intrastate rates for services containing implicit subsidy, but also the proposal provides for payment of the federal funding directly to the states. The states would determine the distribution of the funds based upon an approved plan. Under the proposal, states should be permitted to distribute funding based upon the extent of local exchange competition, the "build-out responsibilities" of CLECs or promotion of investment in selected areas of the state. This appears to be in direct contradiction to the statement on page 16 of the proposal that "distribution of federal funds will be made only to ETCs for the purpose of defraying high local rates for universal service in high cost, rural and insular areas" (which is the putative purpose of the universal service provisions of the Communications Act).

7. The plan purports to be competitively neutral solely because federal funds would be distributed to state commissions. As discussed previously, this plan does not foster competition in all areas of the nation. Consumers in high cost areas will never receive the benefits of competition and neither CLECs nor ILECs will be able to recover costs in high cost areas.

8. While the proposal claims that support would be distributed based on costs, as discussed in 2. above, much effort has been made to arbitrarily limit the size of the fund.

9. Curiously, the authors of the proposal believe that litigation risks are minimized by their approach. To the contrary, the proposal makes support unpredictable; is predisposed to underestimating the cost of providing universal service and, hence, the amount of support that is necessary; and retains implicit support in direct contravention to the Act's requirement. These are attributes which beg judicial intervention.

11. The Working Group argues that the Commission's plan would not provide support to the intrastate jurisdiction. In a footnote, however, the Working Group recognizes that customers in all states benefit in the form of national reductions in interstate toll rates. As noted above, BellSouth believes that the federal fund can provide direct support to the state jurisdictions so as to remove implicit subsidies in intrastate rates. Such support must be in addition to that necessary to remove the implicit subsidies contained in interstate access charges.

Conclusion

For the reasons explained above, the Working Group's proposal cannot be used to establish a federal universal service fund. The proposal is neither consistent with the express requirements of the Communications Act nor an equitable means of providing high cost areas with universal service support.

CERTIFICATE OF SERVICE

I do hereby certify that I have this 6th day of February 1998 served all parties to this action with a copy of the foregoing **REPLY COMMENTS** by placing a true and correct copy of the same in the United States Mail, postage prepaid, addressed to the parties listed on the attached service list.

Juanita H. Lee

Juanita H. Lee

SERVICE LIST CC DOCKET 96-45 REPORT TO CONGRESS

Paul A. Bullis
Chief Counsel, Legal Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007-2996

Kathleen Q. Abernathy
David A. Gross
AirTouch Communications, Inc.
1818 N Street, N. W.
Washington, D. C. 20036

Charles D. Cosson
Pamela J. Riley
AirTouch Communications, Inc.
One California Street, 29th Floor
San Francisco, CA 94111

Joel B.Shifman, Esq.
The Maine Public Utilities Commission
State House Station #18
242 State Street
Augusta, ME 04333

Peter Bluhm, Esq.
The Vermont Public Service Board
112 State Street
Drawer 20
Montpelier, VT 05620-2701

Sheldon Katz, Esq.
The Vermont Department of Public Service
112 State Street
Drawer 20
Montpelier, VT 05620-2701

Alex Pearl
Access Authority, Inc.
27 North Third Street
Philadelphia, PA 19106

Russell M. Blau
Tamar Haverty Finn
Access Authority, Inc.
Swidler & Berlin, Chtd.
3000 K Street, N. W., Suite 300
Washington, D.C. 20007

Elaine Carpenter
Aliant Communications Company
1440 M Street
Lincoln, NE 68508

George Vradenbury, III
William W. Burrington
Jill A. Lesser
Steven N. Teplitz
America Online, Inc.
1101 Connecticut Avenue, N. W., Suite 400
Washington, D.C. 20036

Donna N. Lampert
A. Sheba Chacko
Elizabeth A. Dees
Mintz, Levin, Cohn, Ferris, Glovsky
and Popeo, P C.
701 Pennsylvania Avenue, N. W.
Suite 900
Washington, D. C. 20004-2608

Michael S. Pabian
Ameritech
Room 4H82
2000 West Ameritech Center Drive
Hoffman Estates, IL 60196-1025

Lon C. Levin
Vice President and Regulatory Counsel
AMSC Subsidiary Corporation
10802 Park Ridge Boulevard
Reston, Virginia 20191

Mark C. Rosenblum
Peter H. Jacoby
Judy Sello
AT&T
Room 3245I1
295 North Maple Avenue
Basking Ridge, NJ 07920

A. W. Brothers
President
Beehive Telephone Companies
2000 E. Sunset
Lakepoint, UT 84074

Lawrence W. Katz
Bell Atlantic
1320 North Court House Road
8th Floor
Arlington, VA 222201

John A. Ligon
Business Networks of New York, Inc.
Gibbons, Del Deo, Dolan, Griffinger
& Vecchione
One Riverfront Plaza
Newark, New Jersey 07102-5497

Paul Schumacher
General Counsel
Community Internet Systems, Inc.
P. O. Box 81
Columbus, NE 68602-0081

B. Hunt Baxter, Jr.
Henderson, Baxter, Alford & Taylor, P.A.
Post Office Drawer U
New Bern, North Carolina 28563

Anthony M. Marquez
First Assistant Attorney General
Colorado Public Utilities Commission
Office of the Attorney General
1525 Sherman Street-6th Floor
Denver, Colorado 80203

James R. Coltharp
COMCAST CORPORATION
1317 F Street, N. W.
8th Floor
Washington, D. C. 20004

Joseph W. Waz, Jr., Esq.
Comcast Corporation
1500 Market Street
Philadelphia, Pennsylvania 19102

Jeffery E. Smith, Esq.
Comcast Cellular Communications, Inc.
480 East Swedesford Road
Wayne, Pennsylvania 19087

Barbara A. Dolley
Ronald L. Plesser
Mark J. O'Connor
James J. Halpert
Stuart P. Ingis
Commercial Internet Exchange Assoc.
Piper & Marbury L.L.P.
Seventh Floor, 1200 Nineteenth Street, N. W.
Washington, D.C. 20036

Randolph J. May
Compuserve Incorporated
Sutherland, Asbill & Brennan
1275 Pennsylvania Avenue, N. W.
Washington, D. C. 20004-2404

Nicholas P. Miller
William Malone
Matthew C. Ames
EDLINC
Miller & Van Eaton, P.L.L.C.
Suite 1000, 1150 Connecticut Avenue
Washington, D. C. 20036-4306

Kathy L. Shobert
Director, Federal Affairs
General Communication, Inc.
901 15th Street, N. W., Suite 900
Washington, D.C. 20005

John F. Raposa, HQE03J27
GTE Service Corporation
P. O. Box 152092
Irving, TX 75015-2092

Andre J. Lachance
GTE Service Corporation
1850 M Street, N. W.
Suite 1200
Washington, D.C. 20036

Jonathan Jacob Nadler
Information Technology Association of America
Squire, Sanders & Dempsey LLP
1201 Pennsylvania Avenue, NW
P. O. Box 407
Washington, D.C. 20044

Colleen Boothy
Mark Johnson
Information Technology Industry Council
Levine, Blaszak, Block and Boothby, LLP
2001 L Street, N. W. Suite 900
Washington, DC 20036

Colleen Boothby
Thomas Lynch
Internet Access Coalition
Levin, Blaszak, Block and Boothby, LLP
2001 L Street, NW, Suite 900
Washington, DC 20036

Bruce Schoonover, Sr.
Executive Vice President
John Staurulakis, Inc.
6315 Seabrook Road
Seabrook, MD 20706

George M. Fleming
Mississippi Public Service Commission
Public Utilities Staff
Walter Sillers State Office Building
P. O. Box 1174
Jackson, Mississippi 39215-1174

Phillip L. Spector
Patrick S. Campbell
The National Railroad Passenger Corporation
Paul, Weiss, Rifkind, Wharton & Garrison
1615 L Street, N. W., Suite 1300
Washington, DC 20036

Mary W. Nielsen
302 Hazel Street
Plentywood, MT 59254

Mary J. Sisak
Mary L. Brown
MCI Telecommunications Corporation
1801 Pennsylvania Avenue, N.W.
Washington, DC 20006

Howard J. Symons
Michelle M. Mundt
National Cable Television Association, Inc.
Mintz, Levin, Cohn, Ferris, Glovsky
and Popeo, P.C.
71 Pennsylvania Avenue, N. W., Suite 900
Washington, DC 20004

Daniel L. Brenner
Neal M. Goldberg
David L. Nicoll
National Cable Television Association, Inc.
1724 Massachusetts Avenue, N. W.
Washington, DC 20036

Anthony F. Sanchez, III, Esquire
Assistant General Counsel
Public Utilities Commission of Nevada
727 Fairview Drive
Capitol Complex
Carson City, Nevada 89710

Mark J. Golden
Robert L. Hoggarth, Esq.
Angela E. Giancarlo, Esq.
Personal Communications Industry Association
500 Montgomery Street, Suite 700
Alexandria, VA 22314-1561

Joe D. Edge
Tina M. Pidgeon
Puerto Rico Telephone Company
Drinker Biddle & Reath LLP
901 15th Street, N. W., Suite 900
Washington, D.C. 20005

William W. Barr
Executive Director
Richland Economic Development
121 3rd Avenue, N. W.
Sidney, Montana 59270

Robert M. Lynch
Durward D. Dupre
Darryl W. Howard
Robert J. Gryzmala
SBC Communications, Inc.
One Bell Center, Room 3532
St. Louis, Missouri 63101

Jay C. Keithley
Leon M. Kestenbaum
Sprint Corporation
1850 M Street, N.W. 11th Floor
Washington, DC 20036-5807

John W. Katz, Esquire
Special Counsel to the Governor
Director, State-Federal Relations
State of Alaska
Suite 336
444 North Capitol Street, N. W.
Washington, D.C. 20001

Michael O. Leavitt
Governor of Utah
State of Utah
Office of the Governor
Salt Lake City Utah 84114-0601

Charles C. Hunter
Catherine M. Hannan
Telecommunications Reellers Association
Hunter Communications Law Group
1620 I Street, N. W.
Suite 701
Washington, D.C. 20006

Gail Garfield Schwartz
V.P. Public Policy & Govt. Affairs
Paul Cain
Director Public Policy & Govt. Affairs
Teleport Communications Group, Inc.
Two Teleport Drive
Staten Island, N. Y. 10311

Timothy R. Rugh
Executive Director
The United States Internet Providers Association
8201 Greensboro Drive, Suite 300
McLean, VA 22102

Jeffrey L. Sheldon
Sean A. Stokes
UTC, The Telecommunications Association
1140 Connecticut Avenue, N. W.
Suite 1140
Washington, D.C. 20036

Robert B. McKenna
John L. Traylor
U S West, Inc.
Suite 700
1020 19th Street, N. W.
Washington, DC 20036

Tony Knowles
Jim Geringer
Western Governors Association
600 17th Street
Suite 1705 South Tower
Denver, Colorado 80202-5452

Paul Curl
Acting Secretary
State of Washington
Washington Utilities and Transportation Commission
1300 S. Evergreen Park Drive, S. W.
P. O. Box 47250
Olympia, Washington 98504-7250

Catherine R. Sloan
Richard L. Fruchterman
Richard S. Whitt
WorldCom, Inc.
1120 Connecticut Avenue, N. W.
Suite 400
Washington, D. C. 20036

Carol S. Verosky
Assistant Attorney General
Office of the Attorney General
Wyoming Public Service Commission
Capitol Building
Cheyenne, Wyoming 82002

Dennis L. Bybee, Ph.D
VP and Executive Director
Global Village Schools Institute (GVSI)
P. O., Box 4463
Alexandria, VA 22303

Joseph K. Witmer, Assistant Counsel
Frank Wilmarth, Deputy Chief Counsel
John F. Povilaitis, Chief Counsel
The Pennsylvania Public Utility Commission
P. O. Box 3265
Harrisburg, PA 17105-3256

Marianne A. Townsend
Vice President Regulatory
SmarTalk Conquest
5500 Frantz Road, Suite 125
Dublin, OH 43017

Lorin V. Jones, Senate Chair
Beverly A. Evans, House Chair
Utah State Legislature
Salt Lake City, Utah

James M. Tennant
President
Low Tech Designs, Inc.
1204 Saville Street
Georgetown, SC 29440

Kimberly S. Snyder
Executive Director
Nebraska Telephone Association
801 Lincoln Square
121 13th Street
Lincoln, NE 68508

Ted Stevens
Conrad Burns
United States Senate
Committee on Appropriations
Washington, DC 20510-6025

*Sheryl Todd
Federal Communications Commission
Universal Service Branch
8th Floor
2100 M Street, N. W.
Washington, DC 20554

James A. Burg
Pam Nelson
Laska Schoefelder
South Dakota Public Utilities Commission
State Capitol Building
500 East Capitol Avenue
Pierre, South Dakota 57501-5070

Mary McDermott
Linda Kent
Keith Townsend
Hance Haney
United States Telephone Association
1401 H Street, NW, Suite 600
Washington, D.C. 20005

Sandra K. Williams
Sprint Corporation
P. O. Box 11315
Kansas City, MO 64112

Robert M. Halperin
State of Alaska
Crowell & Moring LLP
1001 Pennsylvania Avenue, N. W.
Washington, D.C. 20004

*The Honorable Susan P. Ness, Commissioner
Federal Communications Commission
1919 M Street, N. W.
Room 832
Washington, D.C. 20554

*The Honorable Gloria Tristani, Commissioner
Federal Communications Commission
1919 M Street N. W
Room 826
Washington, D.C. 20554

*The Honorable Harold W. Furchtgott-Roth
Commissioner
Federal Communications Commission
1919 M Street, N. W.
Room 802
Washington, D.C. 20554

The Honorable H. Russell Frisby, Jr.
Chairman
Maryland Public Service Commission
16th Floor
6 Paul Street
Baltimore, MD 21202-6806

The Honorable Laska Schoemfelder
South Dakota Public Utility Commission
500 East Capital Avenue
Pierre, SD 57501-5070

The Honorable Julia Johnson
Commissioner
Florida Public Service Commission
Capital Circle Office Center
2540 Shummard Oak Blvd.
Tallahassee, FL 32399-0850

The Honorable David N. Baker
Georgia Public Service Commission
244 Washington Street, SW
Atlanta, Georgia 30334-5701

*** VIA HAND DELIVERY**